Supreme Court, U.S.
FILED
MAR 23 1987
JOSEPH F. SPANIOL, JR.
CLERK

No. 86-1412

In The
Supreme Court of the United States
October Term, 1986

SANFORD ROSENBLOOM and SANFORD ROSENBLOOM AS EXECUTOR OF THE ESTATE OF DAVID B. ROSENBLOOM, DECEASED,

Petitioners,

v.

BENJAMIN ROTHBERG,

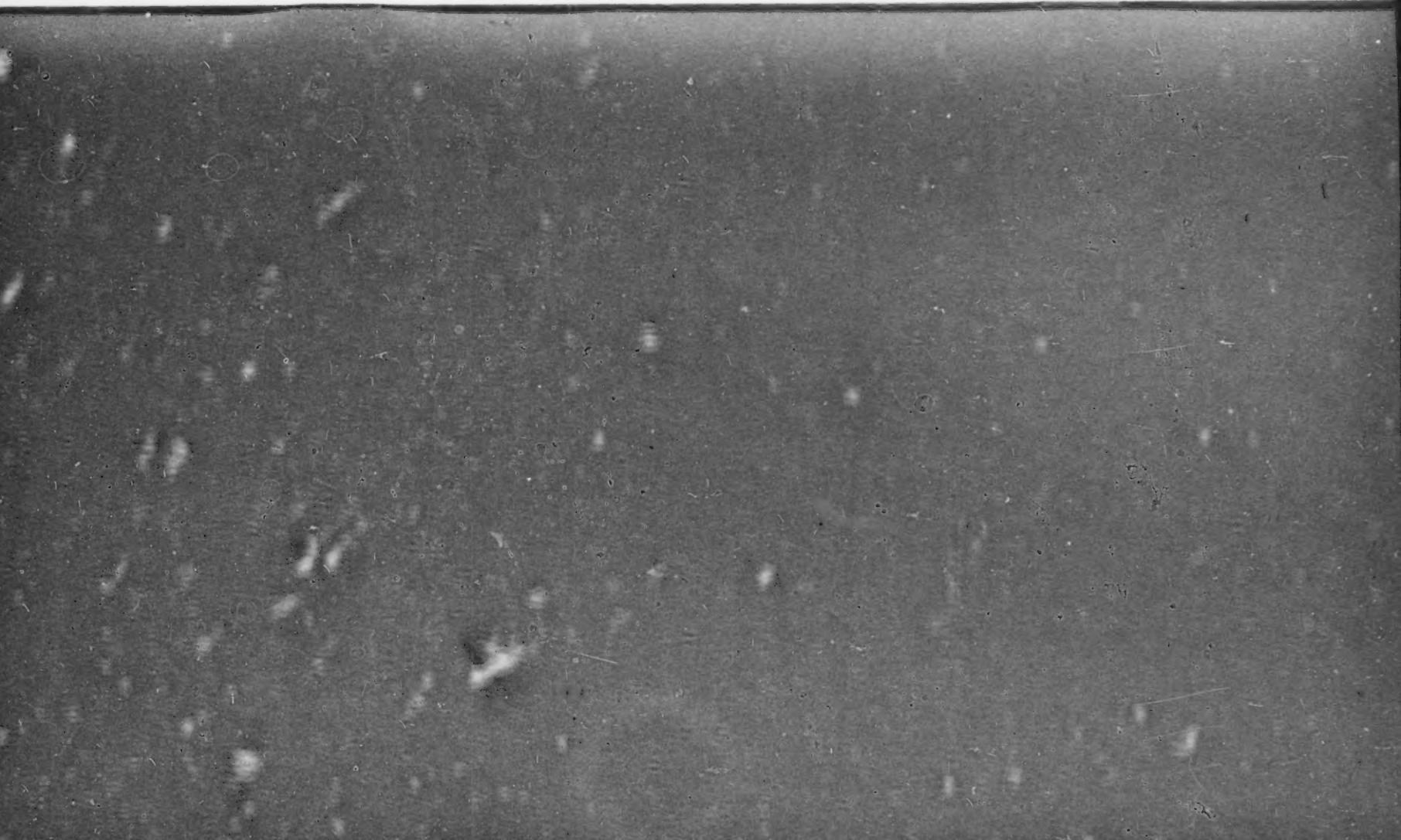
Respondent.

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

STEWART DALZELL
ALFRED W. PUTNAM, JR.
DRINKER BIDDLE & REATH
1100 Philadelphia National
Bank Building
Broad and Chestnut Streets
Philadelphia, PA 19107
(215) 988-2700

Attorneys for Respondent

COCKLE LAW BRIEF PRINTING CO., (800) 225-6964
or call collect (402) 342-2831



RESTATEMENT OF THE QUESTIONS PRESENTED

I. Did the lower courts err in applying federal law to a defense asserted in reliance on the Securities Exchange Act?

II. If the lower courts should have applied Pennsylvania law to that federal defense (which is denied), would it have made any difference in the result here?

III. Did the Court of Appeals misapply this Court's recent *Bateman Eichler* decision to the facts of this case?

TABLE OF CONTENTS

	Page
OPINIONS BELOW, JURISDICTION, AND STATUTES INVOLVED	1
STATEMENT OF THE CASE	2
REASONS FOR DENYING THE WRIT	6
I. Pennsylvania Law Does Not Apply To A Defense Premised On The Federal Securities Laws	7
II. Pennsylvania Law Does Not Help Petitioners In Any Event	9
III. The Court Of Appeals' Application Of *Bateman Eichler* Was Soundly Based	11
CONCLUSION	13

TABLE OF AUTHORITIES

Page

FEDERAL CASES:

Bateman Eichler, Hill Richards, Inc. v. Berner, 472 U.S. 299 (1985) ..... *passim*

Dahl v. Pinter, 787 F.2d 985 (5th Cir. 1986) 11

Erie Railroad v. Tompkins, 304 U.S. 64 (1938) 7, 8, 9

Kuehnert v. Texstar Corp., 412 F.2d 700 (5th Cir. 1969) 11

Nathanson v. Weis, Voisin, Cannon, Inc., 325 F. Supp. 50 (S.D. N.Y. 1971) 11

Rothberg v. Rosenbloom, 771 F.2d 818 (3d Cir. 1985) 3, 5, 8

Rothberg v. Rosenbloom, 808 F.2d 252 (3d Cir. 1986) ..... *passim*

Swift v. Tyson, 16 Pet. 1 (U.S. 1842) 7, 9

Tarasi v. Pittsburgh National Bank, 555 F.2d 1152 (3d Cir. 1977), *cert. denied*, 434 U.S. 965 (1977) 4, 5

STATE CASES:

Allen v. Line, 11 Pa. Super. 517 (1899) 10

Contractor Industries v. Zerr, 241 Pa. Super. 92, 359 A. 2d 803 (1976) 9

Holt v. Green, 73 Pa. 198 (1873) 10

New York & Pennsylvania Co. v. Cunard Coal Co., 286 Pa. 72 (1926) 10

O'Brien v. O'Brien Steel Construction Co., 440 Pa. 375, 271 A.2d 254 (1970) 10

Wright v. Pipe Line Co., 101 Pa. 204 (1882) 10

TABLE OF AUTHORITIES—Continued

Page

STATUTES:

Rules of Decision Act, 28 U.S.C. § 1652 1
Securities Exchange Act § 10(b), 15 U.S.C. § 78j(b) ... 4
Securities Exchange Act § 29, 15 U.S.C. § 78cc 4

RULES:

Supreme Court Rule 17.1 12

No. 86-1412

In The
Supreme Court of the United States
October Term, 1986

SANFORD ROSENBLOOM and SANFORD ROSENBLOOM AS EXECUTOR OF THE ESTATE OF DAVID B. ROSENBLOOM, DECEASED,

Petitioners,

v.

BENJAMIN ROTHBERG,

Respondent.

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

OPINIONS BELOW, JURISDICTION, AND STATUTES INVOLVED

Respondent agrees with petitioners' statement of the opinions below and the jurisdiction of the respective Courts, noting only that the December 29, 1986 opinion of the Court of Appeals has now been published and appears at 808 F.2d 252 (3d Cir. 1986). Respondent does not agree that the Rules of Decision Act, 28 U.S.C. § 1652, has anything to do with this case, and notes that it was

never referred to in any of the opinions, briefs or memoranda below.

———o———

STATEMENT OF THE CASE

Respondent Benjamin Rothberg filed this relatively simple contract case almost four years ago. Rothberg sued on two promissory notes and a guaranty, all of which were dated February 7, 1979. Jurisdiction was based on diversity of citizenship.

The makers of the notes and guaranty in question, David and Sanford Rosenbloom (who were brothers), conceded the authenticity and validity of the documents. They defended on an entirely unexpected ground: these otherwise valid obligations, they contended, should not be enforced because they arose out of two joint venture agreements the parties had entered into some ten years before. The 1969 joint ventures, the Rosenblooms said, were actually agreements to trade on inside information. As such they were illegal under the federal securities laws, and so any contract or note connected to them was also illegal, no matter how remote.

This defense came as a shock to Mr. Rothberg for at least four different reasons. First, the 1969 joint ventures had not—at least as far as Rothberg knew—been formed in order to trade on inside information.[1] Second,

---

1. Mr. Rothberg is not a lawyer and could not pretend to understand the precise boundaries of federal insider trading law as it stood in 1969. It should be noted, however,

(Continued on following page)

both the notes and the joint ventures had been prepared by lawyers at Schnader, Harrison, Segal & Lewis, the highly respected Philadelphia law firm where Sanford Rosenbloom was (and is) a partner, and Mr. Rothberg was understandably stunned to hear that Mr. Rosenbloom could repudiate as "illegal" documents that his own office had prepared. Third, even if the 1969 joint ventures were attacked, the fact was that the Rosenblooms in 1972 had, and for a new consideration, explicitly waived any defenses they might have had to their obligations under those documents.[2] Finally, Mr. Rothberg was advised that the notes were not void or voidable under the securities laws in any event for the simple reason that they did not run afoul of § 29 of the Securities Ex-

---

(Continued from previous page)

that there was considerable legal debate below on whether the 1969 ventures did in fact run afoul of the Securities Exchange Act. One of these arguments allegedly involved an "inside" prediction of 1969 calendar year earnings, which prediction was made *in the first quarter* of that year. The other venture involved allegedly "inside" information that had been printed in a *Wall Street Journal* article a month before the joint venture was formed. Mr. Rothberg continues to believe that the 1969 ventures were legal under the law as it stood then and as it stands now, but he did not prevail on this argument below. *See Rothberg v. Rosenbloom,* 771 F.2d 818 (3d Cir. 1985) (hereinafter referred to as "Rothberg I").

2. On April 7, 1972, Sanford Rosenbloom wrote to Mr. Rothberg acknowledging and confirming that the debt was justly due and owing "without any defense, counterclaim or setoff whatsoever." David Rosenbloom endorsed his brother's letter. Mr. Rothberg argued below that this writing by a member of the bar and supported by a new consideration was a waiver of the Rosenblooms' *in pari delicto* defense, if indeed they ever had such a defense. The lower courts never explained why it was not.

change Act, 15 U.S.C. § 78cc, the section of the Act governing the legality and illegality of contracts.

These evident problems with the Rosenblooms' startling defense did not ensure its early demise, however. The Rosenblooms conceded that they had no illegality claim based on § 29 of the Securities Exchange Act and they expressly waived that argument.[3] Instead they relied *exclusively* on the equitable doctrine of *in pari delicto*. That doctrine had been used, at least in the Third Circuit, to defeat suits brought by tippees against their tippers pursuant to § 10(b) of the Securities Exchange Act. *Tarasi v. Pittsburgh National Bank*, 555 F.2d 1152 (3d Cir.), *cert. denied*, 434 U.S. 965 (1977). The Rosenblooms contended that this logic should be applied to Mr. Rothberg's contract action inasmuch as he was Mr. Rosenbloom's "tippee."

The Honorable Marvin Katz of the District Court for the Eastern District of Pennsylvania accepted this argument. He concluded that the 1969 joint ventures had been based on illegal tips from an insider and that the *Tarasi* case set forth a policy forbidding the enforcement of notes or contracts descended from those joint ventures.

---

3. In the words of the Rosenblooms' counsel:

> Plaintiff incorrectly assumes that defendants contentions must necessarily be based on Section 29(b) of the Securities Exchange Act. . . . Defendants' argument . . . is *not* that the notes and guaranty are invalid under Section 29(b), but rather that they are unenforceable under the doctrine of *in pari delicto* because, to enforce them, would assist the plaintiff . . . in violation of Section 10(b) of the Act.

Defendants' Brief in Opposition to Plaintiff's Motion for Summary Judgment, 48 (filed January 3, 1984).

Mr. Rothberg appealed. While the appeal was pending, however, this Court decided *Bateman Eichler, Hill Richards, Inc. v. Berner,* 472 U.S. 299 (1985), holding that a tippee was not (at least in the typical case) "*in pari delicto*" with his tipper. This holding, which overruled *Tarasi,* undermined the entire basis of the Rosenblooms' defense and the rationale of the District Court's opinion.

Not surprisingly, the Court of Appeals in *Rothberg I* remanded the case for further consideration in light of *Bateman Eichler,* and the Rosenblooms were afforded an opportunity to show how their case might fit under an exception to the newly announced *Bateman Eichler* rule. The Rosenblooms declined this opportunity, however, and produced no new evidence that might have distinguished this case from *Bateman Eichler.*

That was not the end of the matter, however, for Judge Katz proceeded to apply *in pari delicto* a second time. But in order to do so he had to do some violence to the record before him. Mr. Rothberg was therefore transformed into the "instigator" and "financier" [628 F. Supp. at 753] of a "crooked scheme" [628 F. Supp. at 747] while the Rosenblooms became weaklings manipulated by the all-powerful and all-knowing Rothberg [628 F. Supp. at 757-58]. Mr. Rothberg's culpability, Judge Katz concluded, could be said to "fairly out-weigh" that of the Rosenblooms [628 F. Supp. at 753] and the *Bateman Eichler* decision could therefore be distinguished. The record, however, was clear that the Rosenblooms, not Mr. Rothberg, came up with the idea for the now-tainted joint ventures. Mr. Rothberg provided only the money, and none of the allegedly "inside" information. Mr. Rothberg thus appealed a second time.

This time the Court of Appeals reversed. While each member of the three-judge panel wrote an opinion in *Rothberg* II, all three found clearly erroneous Judge Katz's "findings" that Mr. Rothberg was the "instigator" of the scheme and that he exercised undue influence over the Rosenblooms. Indeed, the record unambiguously established that the Rosenblooms, not Mr. Rothberg, had come up with the scheme and promoted it. Judges Rosenn and Seitz concluded from this that the record would not support a departure from the policy this Court set forth in *Bateman Eichler*. Judge Sloviter, while agreeing that the record did not support the District Court's findings, concluded that there was evidence sufficient to distinguish the case from *Bateman Eichler* on its facts.

The Rosenblooms now ask this Court to issue a writ of certiorari. In so doing, they have lived up to their past record as masters of the unexpected. Having injected both the federal interest and the *in pari delicto* issue into this case over Mr. Rothberg's stunned (and initially ineffective) objection, they *now* say that the case is a Pennsylvania contract action and should only be governed by Pennsylvania law! This complete reversal of everything the Rosenblooms have said and done up until now simply does not work.

REASONS FOR DENYING THE WRIT

The reasons the Rosenblooms advance for granting their petition rest on a misunderstanding of the applicable law. First, the application of a defense premised on the federal securities laws is a matter of federal law, not

state law, and the invocation of *Erie Railroad v. Tompkins,* 304 U.S. 64 (1938), is thus off the point. Second, even if this were a case for Pennsylvania law, that law provides no solace for the Rosenblooms—a point they recognized by raising the federal defense in the first place. Third, the Court of Appeals' refusal to apply the *in pari delicto* defense to a contract action brought by a tippee against his tipper is not "bad precedent" and is not only consistent with but is compelled by this Court's recent opinion in *Bateman Eichler.* These three points are addressed in turn.

I. Pennsylvania Law Does Not Apply To A Defense Premised On The Federal Securities Laws

The Rosenblooms hope to persuade this Court that the Court of Appeals erred in applying federal law to the defense they raised under the federal securities laws. They even go so far as to wave the bloody shirt of *Swift v. Tyson,* 16 Pet. 1 (U.S. 1842), implying that they would have met a very different fate in a Pennsylvania court than they ultimately met in the Court of Appeals. This argument errs.

It was the Rosenblooms who asserted that the notes and guaranty on which Mr. Rothberg brought this suit could not be enforced because those documents were lineal descendants of agreements entered into in violation of the Securities Exchange Act. It was the Rosenblooms who claimed that Mr. Rothberg had been involved in an insider trading scheme that was "illegal" under *federal* law, a contention the Court of Appeals accepted in *Roth-*

berg I, 771 F.2d 818 (3d Cir. 1985). These allegations, and the public policy considerations surrounding them, are obviously matters of *federal* concern. The Rosenblooms are right in at last recognizing that Mr. Rothberg's complaint stated only a simple Pennsylvania contract case. They are wrong in refusing to acknowledge that their own answer raised a federal defense.

Judge Seitz explained how this defense affected the case:

> I emphasize at the outset that although this is a diversity action, the doctrine of *Erie Railroad v. Tompkins,* 304 U.S. 64, 58 S. Ct. 817, 82 L.Ed. 1188 (1938), is not applicable to defenses raised under federal law. As the Supreme Court has explained,
>
> > When a federal statute condemns an act as unlawful, the extent and nature of the legal consequences of the condemnation . . . are . . . federal questions, the answers to which are to be derived from the statute and the federal policy which it has adopted. To the federal statute and policy, conflicting state law and policy must yield. *Sola Electric Co. v. Jefferson Electric Co.,* 317 U.S. 173, 176, 63 S.Ct. 172, 174, 87 L.Ed. 165 (1942) (holding that local laws of estoppel are not applicable where the defense asserted in a diversity contract action is based on federal law); *see also Kelly v. Kosuga,* 358 U.S. 516, 519, 79 S.Ct. 429, 431, 3 L.Ed. 2d 475 (1959).

808 F.2d at 259 (Seitz, J. concurring). This view, which the Rosenblooms now challenge, was shared by Judge Rosenn (808 F.2d at 254 n.2) and by Judge Sloviter, the lone dissenter below:

> Judge Seitz states that federal law and federal policy should apply to determine whether the *in pari*

> *delicto* defense is available in contract actions. I do not disagree because any right of Rothberg to recover under the state contracts law must yield to a federal policy expressed in or underlying federal law that would preclude such recovery.

808 F.2d at 261-62 (Sloviter, J. dissenting).

It is thus not true that this case threatens to destroy *Erie Railroad v. Tompkins* or to resurrect *Swift v. Tyson*. It has nothing to do with either case. In terms of choice of law, it stands only for the proposition that federal law is applied to defenses based on federal law. Any contrary rule, of course, would destroy the very uniformity the Rosenblooms claim to cherish.

II. Pennsylvania Law Does Not Help Petitioners In Any Event

Even if this Court were to become converted to the novel proposition that Pennsylvania law should guide the courts in their application and interpretation of defenses premised on the federal securities laws, it is worth noting that Pennsylvania's law would bring no comfort to the Rosenblooms in this case.

Under Pennsylvania law, the notes at issue here would be enforceable *even if they were related to an allegedly illegal transaction.* For a Pennsylvania court to dishonor a claim on the ground of illegality, "[t]he illegality must appear from *the plaintiff's* statement of his cause of action." *Contractor Industries v. Zerr,* 241 Pa. Super. 92, 97, 359 A.2d 803, 805 (1976) (Spaeth, J.) (emphasis added). If the plaintiff does not need to rely on the al-

leged illegality to prove his case, defendant's assertion of an underlying or collateral illegality will not prevail against him. *O'Brien v. O'Brien Steel Construction Co.*, 440 Pa. 375, 380, 271 A.2d 254, 256 (1970); *New York & Pennsylvania Co. v. Cunard Coal Co.*, 286 Pa. 72, 81 (1926); *Allen v. Line*, 11 Pa. Super. 517, 526 (1899); *Wright v. Pipe Line Co.*, 101 Pa. 204, 207 (1882); *Holt v. Green*, 73 Pa. 198, 200-01 (1873).

In the present case, of course, Mr. Rothberg sued on two notes and a guaranty that were themselves conceded to be valid. He did not need to rely—and did not rely—on the allegedly illegal 1969 joint venture agreements. No Pennsylvania court, then, would have "unravel[led] the transaction to discover its origin."[4] The only different result the Rosenblooms would have encountered under Pennsylvania law, then, was a speedier end to their sole defense.

Had this case been brought in a Pennsylvania court, of course, the Pennsylvania judge would not have applied Pennsylvania law. Following the reasoning set forth above, he would have applied federal law to a federal defense. If he got it wrong, however, he would still have reached the same result, only faster. The Rosenblooms' effort to raise the spectre of forum-shopping is thus whol-

---

4. *Wright v. Pipe Line Co.*, 101 Pa. 204, 207 (1882) ("True it is that an illegal contract will not be executed; but when it has been executed by the parties themselves, and the illegal object of it has been accomplished, the money or thing which was the price of it may be a legal consideration between the parties for a promise, express or implied, and the court will not unravel the transaction to discover its origin.")

ly without substance and hardly constitutes a reason for this Court to grant their petition.

III. The Court Of Appeals' Application Of Bateman Eichler Was Soundly Based

The only real issue the petition presents, then, is whether the Court of Appeals erred in its interpretation and application of this Court's recent *Bateman Eichler* decision. In *Bateman Eichler,* this Court laid to rest a long-standing dispute regarding the applicability of the *in pari delicto* defense in cases brought by tippees against their tippers. The defense had been allowed, over a strong dissent, in *Kuehnert v. Texstar Corp.,* 412 F.2d 700 (5th Cir. 1969). It had been rejected by Judge Weinfeld in his seminal opinion in *Nathanson v. Weis, Voisin, Cannon, Inc.,* 325 F. Supp. 50 (S.D. N.Y. 1971). Over the next fifteen years, the various circuits split in support of these two views. The question was plainly one on which reasonable people might differ. In the end, Judge Weinfeld's view prevailed in *Bateman Eichler.*

Unless this Court wishes to strangle *Bateman Eichler* in its crib,[5] which seems unlikely, the issue effectively reduces to whether this case is that anticipated by the narrow exception announced in that opinion. In *Bateman Eichler,* this Court held that a tippee does *not* bear "sub-

---

5. *Bateman Eichler* was decided less than two years ago. Since that time, Rothberg is aware of only two Court of Appeals decisions that address the applicability of any exceptions to the general rule *Bateman Eichler* enunciated. Both of these decisions—the present case and *Dahl v. Pinter,* 787 F.2d 985 (5th Cir. 1986)—have declined to narrow this Court's *Bateman Eichler* rule.

stantially equal responsibility'' with his tipper and that the tipper may therefore not ordinarily rely upon *in pari delicto*. A different result is possible only where the defendant can point to "other culpable actions by [the] tippee that can fairly be said to outweigh [the] violations by insiders . . . ." 472 U.S. at 314.

This is the fact-bound inquiry the lower courts undertook in the present case. The District Court claimed to find such culpable conduct. The Court of Appeals concluded that there was no record support for that finding—indeed that the record permitted only the contrary finding. Were this Court now to review this case, it would, in essence, perform the same function that the Court of Appeals has already performed. It would review the factual record below in order to ascertain if the evidence adduced justifies distinguishing this case from the general rule announced in *Bateman Eichler*. While Mr. Rothberg is confident that such a review by this Court would lead to the very result the Court of Appeals reached below, this Court's Rule 17.1 suggests that such generalized oversight is not a task this Court usually undertakes, and therefore the petition should be denied.

———o———

CONCLUSION

Petitioners have offered no reason why this Court should exercise general review of the Court of Appeals' application of the recently-decided *Bateman Eichler* decision to the facts of this case. Their petition for a writ of certiorari to the United States Court of Appeals for the Third Circuit should, therefore, be denied.

Respectfully submitted,

STEWART DALZELL
ALFRED W. PUTNAM, JR.
DRINKER BIDDLE & REATH
1100 Philadelphia National
Bank Building
Broad and Chestnut Streets
Philadelphia, PA 19107
(215) 988-2700

Attorneys for Respondent